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EXAMINING “EQUITABLE” RETENTION

Lorna Richardson*

Compensation, whereby a liquid debt reduces or extinguishes a liquid debt, is well understood. Similarly, retention of a sum due under a contract on the principle of mutuality is relatively well understood. What is less well understood is the “other type of retention”¹ or “equitable” retention which was discussed *obiter* by Lord Rodger in *Inveresk plc v Tullis Russell Papermakers Ltd.*²

It is argued that when the legal landscape is considered in detail, compensation is a doctrine with a narrower scope than previously understood. Many cases described or pled as compensation are really cases of equitable retention.³ Equitable retention was rarely used by defenders prior to the decision in *Inveresk*. Indeed, Lord Rodger made his comments for fear that this type of retention would continue to be overlooked.⁴ Now that the existence of the doctrine has been highlighted it is important we understand the extent and limits of the doctrine and its interaction with compensation and mutuality retention. It is suggested that there is some commonality between mutuality retention and equitable retention, in that both doctrines permit a party to delay performance until compensation can take place. This aspect of mutuality retention has not featured prominently and, as a result, has caused difficulties.⁵ It is only when the true extent and boundaries of compensation, equitable retention and mutuality retention are understood that the law can develop in a coherent manner, free of confusion that has, to date, existed.

Part A sets out a framework of this area of law including discussion of the categories of retention of debts. Part B considers equitable retention in detail. Finally, Part C provides comment on the factors identified in Part B as influencing the court’s discretion when considering whether equitable retention should be permitted.

A The Legal Framework

A crucial distinction is that which exists between compensation and retention of debts. Compensation operates to extinguish debts. Retention does not. Retention operates to suspend or delay payment only.⁶

It has been said that compensation, like many concepts in Scots law, suffers from the use of inconsistent terminology.⁷ “Compensation” is often used synonymously with “set

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¹ Hume, *Lectures (1786-1822)* Vol III, (Stair Society Vol 15) (ed by GCH Paton, T and A Constable Ltd, Edinburgh, 1952) 55

² [2010] UKSC 19; 2010 SLT 941

³ See discussion on pages 3 - 4. On use of the term “equitable retention” see page 5.

⁴ *Supra* n 2 at para 77

⁵ See discussion on pages 7 - 8

⁶ Stair, *Inst* 1.18.6 and 7; GJ Bell, *Prin* § 1410.

⁷ WW McBryde, *The Law of Contract in Scotland*, (3rd ed, W Green, Edinburgh, 2007), para 25-32.

off". "Set off" may have come into use via English law. However, "set off" denotes a wider principle than claims that can be set against each other in compensation in Scots law.⁸ As such "set off" will not be used in this paper.⁹ Another difficulty lies in the varied meanings of "retention".¹⁰ In this paper "retention" is used to mean a party delaying or suspending fulfilment of an obligation.¹¹ The different categories of retention of debts are set out later in this part.

Some of the difficulties in terminology perhaps stem from the historical development of compensation and retention of debts in Scots law. Many consider retention of debts to be an extension of compensation.¹² An extension of one doctrine from another might result in difficulties determining the boundary between the doctrines with resultant confusion surrounding terms. Whatever the reasons for the terminological problems this paper aims to identify the extent of both compensation and retention of debts, taking into account their distinct effects, and the dividing line between the doctrines.

(1) Compensation¹³

Compensation has been known to the law of Scotland from at least 1592 in the form of the Compensation Act of that year.¹⁴

Compensation operates where claims are liquid¹⁵ and of the same nature - where A has a liquid claim against B for £100 and B has a liquid claim against A for £50 the claims can be set against each other so that B pays the balance of £50 to A. In general an illiquid claim cannot be set off against a liquid claim.¹⁶ A pursuer with a liquid claim should be paid without having to await the outcome of an illiquid claim by the defender against him.¹⁷

⁸ WM Gloag, *The Law of Contract* (2nd ed, W Green, Edinburgh, 1929) 644 footnote 4

⁹ McBryde argues that "set off" might be the better term – *Contract supra* n 7, para 25-33.

¹⁰ WM Gloag and JM Irvine, *Law of Rights in Security: Heritable and Moveable Including Cautionary Obligations* (W Green, Edinburgh, 1897), 303; McBryde, *ibid*, para 25-34

¹¹ This may be until performance of a counter obligation (mutuality retention) or until compensation can take place (mutuality and equitable retention) – see the discussion on pages 4 and 7-8

¹² Lords Hope and Rodger in *Inveresk supra* n 2, paras [32] and [81]. However Bell's *Principles* suggest there is no link between compensation and retention of debts but that retention of debts grew from the right to retain corporeal subjects - Bell *Princ* § 1410, see in particular 10th ed by Guthrie. Gloag & Irvine, *Rights in Security, supra* n 10, 303 although it is difficult to reconcile this with what is said on page 304.

¹³ This paper considers compensation by force of law rather than contractual set off, in terms of which parties make express provision in their contract(s) regarding the setting of claims against each other. Parties might have rights under their express agreement that go beyond the extinction of liquid debts against each other.

¹⁴ There is some doubt as to whether compensation was part of Scots law prior to 1592. Stair states that it was not, *Inst* 1.18.6; as does Hume, *supra* n 1, 28. However Bell asserts otherwise - *Comm* II 126. See Lord Salvesen's comments in *Fowler v Brown* 1916 SC 597 at 602 – 603.

¹⁵ A liquid debt is a debt which is instantly due and payable. As such the sum due must be ascertained or immediately ascertainable. Conversely, an illiquid debt is not instantly due and payable. Indeed, an illiquid debt may not yet be ascertained, such as where damages are sought – the court must determine that damages are payable and the amount due by way of damages.

¹⁶ Gloag & Irvine, *Rights in Security, supra* n 10, 304; Gloag, *Contract, supra* n 8, 624; *Munro v MacDonald's Executors* (1866) 4 M 687 per the Lord President at 688; *Ross v Ross* (1895) 22 R 461 per Lord Adam at 463; *Grewar v Cross* (1904) 12 SLT 84 per Lord Pearson at 85; *M'Connell & Reid v W&G Muir* (1906) SLT 79 per the Lord Justice Clerk at 82; *Hopkirk v Pirie* 1958 SLT (Sh Ct) 9 at 9; *Niven v Clyde Fasteners Ltd* 1986 SLT 344 per Lord Jauncey at 345.

¹⁷ *Pegler v Northern Agricultural Implement and Foundry Co (Ltd)* (1877) 4 R 435 per Lord Deas at 439

Compensation must be pled and sustained.¹⁸ The doctrine is based on utility – the result of allowing claims to be extinguished against each other is that fewer claims have to be raised.¹⁹ In our example B need not raise an action against A to recover £50 due to him. It is also based on equitable principles²⁰ - A should not be paid the sum due to him by B if he has not paid the sum he owes B.

In cases decided shortly after the 1592 Act the rule that compensation only applied to liquid debts was strictly adhered to. In three early 17th century cases²¹ compensation was refused on the basis that the debt due to the defender by the pursuer was not liquid despite the defenders seeking to refer their claims for victual²² to the pursuer's oath.²³ These cases seem to run counter to the terms of the Act which allows debts instantly verified by writ or oath to be set against liquid sums claimed by the pursuer.²⁴ By the late 1600s this stance relaxed and defenders' claims that could be verified instantly by writ or oath were permitted.²⁵ By the mid 1700s the practice had relaxed further with Bankton noting that while the Act required compensation to be instantly verified, if the pursuer took a day to prove his claim the defender was allowed that day to liquidate his grounds of compensation "even by witnesses in matters capable of that mean of proof."²⁶

Erskine *Institute's* appear to go further still stating that,

our uniform practice for near a century, which seems grounded on the Roman law,.. if a debtor in a liquid sum shall plead compensation upon a debt due by his creditor to him, which requires only a short discussion to constitute it, sentence is delayed *ex equitate* against the debtor in the clear debt, that he may have an opportunity of making his ground of compensation according to the rule, *quod statim liquidari potest pro jam liquid habetur*.²⁷

This maxim is defined as "that which can at once be rendered liquid is held as liquid".²⁸ Some of the cases cited by Erskine²⁹ in which this maxim was said to be operating appear to go beyond defenders' claims that could *at once* be rendered liquid and set against the pursuers' claims. The first is *John Seton*.³⁰ Seton sought payment on a bond. The claim was defended by his debtor's widow who claimed Seton was creditor to her husband for the freight of certain voyages. The court descended against the defender but superseded extract for three

¹⁸ Stair stated that compensation would arise *ipso jure* - *Inst* 1.18. 6; but it is clear that is not the case – *Sir William Maxwell of Monreith v Creditors of Sir Godfrey McCulloch* (1738) Mor 2550; Bankton *Inst* 1.4.23; Bell, *Princ* §575; Gloag, *Contract, supra* n 8, 644.

¹⁹ Bell, *Princ* § 572; Hume, *supra* n 1, 28

²⁰ *Ibid*

²¹ *Earl of Linlithgow v Laird of Airth* (1616) Mor 2564; *Lady Balbengo v Lord Lauriston* (1626) Mor 2564; *Campbell v Lord Kinclaiven* (1626) Mor 2656

²² Any sort of grain or corn – Watson, *Bell's Dictionary and Digest of the Law of Scotland*, (7th ed, Edinburgh Legal Education Trust, Edinburgh, 2012, originally published 1890), 1110

²³ There appear to have been other issues preventing the pursuer's oath from determining the matter in *Lady Balbengo* and *Campbell*.

²⁴ Comments in the report of *Ross v Magistrates of Tayne* (1711) Mor 2568 suggest the 1592 Act did not allow claims offered instantly to be liquidated by oath to be compensated.

²⁵ *Stuart v MacDuff* (1674) Mor 2565

²⁶ Bankton *Inst* 1.4.28

²⁷ Erskine *Inst* 3.4.16

²⁸ J Trayner, *Trayner's Latin Maxims* (4th ed, W Green, Edinburgh, 1993), 534

²⁹ Erskine *Inst* 3.4.16

³⁰ (1683) Mor 2566

or four months holding that if the defender's claim could be liquidated by that time compensation was to be received.³¹ The report notes that this decision was

reversing the act, stopping a liquid debt upon an illiquid compensation; and allowing a term to liquidate it,... and though it be materially just, yet it is a great relaxation of our antient form.

In the case of *Brown v Elies*³² the pursuer's liquid claim arose under a bond which had been assigned to him. The defender pled compensation on the basis that the pursuer's cedent was debtor to him. The court initially allowed Elies two weeks to liquidate his claim. This period was prorogated a further three weeks. A further entry to the report, which appears ten months after the initial report, records that the defender had been granted further diligence against a witness to produce writs which were to be used by Elies in proving compensation. It is unclear from the report whether by the date of this later entry decree has been granted against Elies but use of "proving compensation" in the later note indicates it had not.³³

The final case cited is *Muir and Milliken v Kennedy*³⁴ in which the pursuers sought payment of a sum for which the defender's father was cautioner. The defender heir, a minor, offered to prove that payment had been made by the principal or cautioner. A term was assigned to him to do so. He also pled compensation on the basis that Muir had lived several years in this father's house. The court gave the defender a term in which to prove his compensation. The court appears to have been influenced by a number of factors – that the defender was a minor and heir of a cautioner; and that the pursuers were already delayed in obtaining decree by the defender offering to prove payment. The court noted that periods of time had been given in other cases to allow defenders to prove compensation where such "favourable circumstances" as existed in this case were absent.

What is clear from these cases is that compensation was not operating in the sense that the pursuers' claims were extinguished by the defenders' claims. The defenders were simply given a period of time in which they did not have to pay the liquid sum until they had liquidated their illiquid claims. It was only when that occurred that the defenders would be able to compensate their claims against the pursuers' claims. It is argued that what was happening in these cases, while described as compensation, was truly retention until compensation could take place. That these are really cases of retention receives support from Gloag and Irvine who deal with the views set out in Erskine's *Institutes* on these cases as retention.³⁵ Lord Rodger, in *Inveresk*, referred to the cases under the heading "early cases on retention for the purposes of compensation".³⁶ Furthermore, in a later edition of Erskine's *Institutes* a note is added to the discussion of the cases,

the granting of delay for the purposes of liquidating a debt to be *afterwards* the ground of compensation is entirely within the discretion of the Court..³⁷

³¹ When the court supersedes extract it pronounces decree but the extract decree in terms of which the decree can be enforced is delayed for a period.

³² (1686) Mor 2566

³³ Lord Rodger, in discussing the case in *Inveresk plc supra* n 2, considers that decree had not been granted against Elies by the time of the subsequent note – para [88].

³⁴ (1697) Mor 2567

³⁵ Gloag & Irvine, *Rights in Security*, *supra* n 10, 319.

³⁶ *Supra* n 33, paras [86] – [88].

³⁷ Erskine *Inst* 3.4.16 (8th ed), note (b) emphasis added

This seems to be a situation where terminology has caused confusion. These cases and later cases in which defenders have sought to delay payment for a period³⁸ are truly cases of equitable retention, not compensation.³⁹ Compensation encompasses liquid debts against liquid debts or those which are immediately capable of being made liquid. If it would take the defender a period of time, even a short period, to make his claim liquid this is retention. It is suggested that this is where the dividing line between compensation and retention falls.⁴⁰

(2) Retention of Debts

(a) Equitable or Special Retention

Equitable retention may be used where A seeks payment of a liquid debt and B seeks to delay payment of the liquid debt on the basis of an illiquid claim he has against A. If B's claim is not capable of immediately being made liquid it cannot found a plea of compensation. Unless B's claim is based on the same contract or transaction⁴¹ which forms the basis of A's claim against B, retention based on mutuality of contract will not be available. The general rule is that an illiquid claim should not delay payment of a liquid claim. However, this general rule is subject to exception where justice or equity so requires.⁴² As mentioned above the cases of *Seton*, *Brown v Elies* and *Muir and Milliken v Kennedy*⁴³ fall within this category.

The court exercises its equitable discretion based on the facts and circumstances of each case. The factors that a court will consider when exercising its discretion are examined in Part B. At this stage, it is sufficient to note that the general rule that illiquid claims cannot delay liquid claims will only be departed from in special⁴⁴ or exceptional circumstances.⁴⁵ This type of retention might be described as "equitable retention" to distinguish it from retention based on mutuality in contract, taking account of the fact that the court is asked to exercise its equitable discretion. However, given the problems with terminology in this branch of the law it is suggested that "equitable retention" should be avoided. Retention

³⁸ Such as *Scottish North Eastern Railway Co v Napier* (1859) 21 D 700 and *Munro v MacDonald's Executors* (1866) 4 M 687, cited in note (b) referred to in the footnote above.

³⁹ Cf *Gloag and Gloag and Henderson* where the court's equitable discretion to allow an illiquid claim to postpone decree for a liquid claim is considered under the headings of both retention and compensation – *Gloag, Contract, supra* n 8, 625 and 646; *WM Gloag and RC Henderson, The Law of Scotland* (13th ed, W Green, Edinburgh, 2012) paras 3.32 and 10.15. Wilson refers to the court's discretion when discussing compensation – *The Scottish Law of Debt* (2nd ed, W Green/Sweet & Maxwell, Edinburgh, 1991), 161. McBryde considers the issue while discussing compensation but makes clear that there is an exceptional category of cases where the requirements of the Compensation Act, mutuality principle or balancing of accounts in bankruptcy do not apply – *Contract, supra* n 7, para 25.57-25.58.

⁴⁰ Lord M'Laren in *Ross v Ross* (1895) 22 R 461 at 464 – 465, which was cited with approval by Lord Rodger in *Inveresk supra* n 2 at paras [102] – [103].

⁴¹ *Inveresk, ibid*

⁴² *Ross v Ross, supra* n 40, especially Lord Adam at 464; *Gloag & Irvine, Rights in Security, supra* n 10, 305

⁴³ (1683) Mor 2566; (1686) Mor 2566; (1697) Mor 2567

⁴⁴ Lord Rodger in *Inveresk, supra* n 2 at para [112]

⁴⁵ *M'Connell & Reid v W&G Muir* (1906) SLT 79 per the Lord Justice Clerk at 82; *Hopkirk v Pirie* 1958 SLT (Sh Ct) 9 per Sheriff Substitute Hamilton at 9; *Gloag & Irvine, Rights in Security, supra* n 10, 305

based on the mutuality principle is also equitable in nature.⁴⁶ As such it is submitted that “special retention” should be used to distinguish between this type of retention and mutuality retention. “Special retention” will be used in the remainder of this paper.

(b) Balancing of Accounts in Bankruptcy

Where A is bankrupt or *vergens ad inopiam*⁴⁷ B is not obliged to pay a liquid sum due to A, even though B’s claim against A is illiquid. This rule is based on equitable principles – to prevent B being forced to pay his full debt to A while B will receive only a dividend in respect of his debt.⁴⁸

There is some doubt about the effect of the rule on balancing accounts in bankruptcy.⁴⁹ In *A v B*⁵⁰ Lord Drummond Young opined that the balancing of accounts was not retention but was the setting off of one debt against the other, in the same way as compensation, but that on balancing accounts an illiquid claim could be set off against a liquid claim.⁵¹ Lord Drummond Young referred to Gloag, *The Law of Contract* and McBryde, *The Law of Contract in Scotland* as authorities for this view. However, Gloag refers to balancing of accounts in bankruptcy as the operation of the principle of retention. Gloag cites Lord M’Laren in *Ross v Ross*,

The doctrine (of retention) has received much extension in cases on bankruptcy and insolvency, where it is practically settled that anyone who has a claim against an insolvent estate is entitled to keep back money which he owes to the estate, and cannot be compelled to pay in full while he only receives a dividend.⁵²

In the paragraphs of McBryde cited by Lord Drummond Young reference is made to set off rather than compensation.⁵³ For McBryde, set off is something wider than compensation.⁵⁴ Indeed, McBryde has discussed balancing accounts in bankruptcy as retention.⁵⁵

In *Integrated Building Services Engineering Consultants Ltd t/a Operon v Pihl UK Ltd*,⁵⁶ Lord Hodge acknowledged the lack of consensus on this matter.⁵⁷ Lord Hodge did not come to a concluded view but suggested that the effect of balancing accounts in bankruptcy was retention to allow the debtor the opportunity to make his claim against the bankrupt liquid which would then allow compensation to take place. He noted Lord Hope in *Inveresk*⁵⁸ had approved of the discussion of retention in the twelfth edition of Gloag and Henderson,

⁴⁶ Gloag, *Contract*, *supra* n 8, 627; *McNeill v Aberdeen City Council* 2014 SLT 312 per Lord Drummond Young at para [30]

⁴⁷ Defined as “approaching to want or insolvency” - *Trayner’s Latin Maxims*, *supra* n 28, 627

⁴⁸ H Goudy, *A Treatise on the Law of Bankruptcy in Scotland* (4th ed, T&T Clark, Edinburgh, 1914), 551

⁴⁹ It is described as “the equitable right of retention or species of set off available on insolvency” in J St Clair and the Hon Lord Drummond Young, *The Law of Corporate Insolvency in Scotland* (4th ed, W Green, Edinburgh, 2011), para 17-04.

⁵⁰ 2003 SLT 242

⁵¹ *Ibid* para [20]

⁵² Gloag, *Contract*, *supra* n 8, 626.

⁵³ *Supra* n 50 at para [20]. McBryde, *Contract*, *supra* n 7, para 25-62

⁵⁴ *Ibid*, para 25-33

⁵⁵ McBryde, *Bankruptcy*, (2nd ed, W Green, Edinburgh, 1995), para 16-57

⁵⁶ [2010] CSOH 80. Lord Hodge’s decision was referred to with approval by Lord Malcolm in *Joint Administrators of Connaught Partnerships Ltd v Perth and Kinross Council* 2014 SLT 608

⁵⁷ *Ibid* at para [23]

⁵⁸ [2010] UKSC 19; 2010 SLT 941

The Law of Scotland, in which the debtor of the bankrupt is entitled to withhold payment until his illiquid claim is ascertained.⁵⁹

It is suggested that this is the correct analysis of the effect of balancing accounts in bankruptcy,⁶⁰ according with Goudy's distinction between compensation proper on the one hand, and compensation as retention on the other.⁶¹

While some consider the balancing of accounts as part of special retention⁶² it is argued that they are distinct categories within the doctrine of retention of debts, both resulting from equitable considerations.⁶³

(c) Retention of Debts based on Mutuality in Contract

This might be described as the better known category of retention. This principle is based on the premise that a party to a contract (A) cannot seek performance from the other party (B) until A is himself ready to perform his obligations under the contract.⁶⁴

For B to be able to retain performance he will have to show that the obligation withheld is the counterpart of the obligation which A has failed to perform.⁶⁵ There is a presumption that obligations undertaken by parties in a contract are counterparts of each other but that presumption can be rebutted where it is shown that the obligations, on an analysis of the contract, are interdependent of each other.⁶⁶ Indeed, the Supreme Court held in *Inveresk*⁶⁷ obligations need not be contained in the same contract to be counterparts of each other - this can happen where one or more contracts make up one transaction such that A's obligations in one contract are the counterpart of B's obligations in another related contract. The unity of the transaction is to be respected.⁶⁸ It appears that the breach of contract by A would also have to be material for B to retain performance, although the breach need not be so material as would justify B rescinding.⁶⁹ Here the qualification "material" is being used in two different senses. For B to rescind the breach must be material. For B to retain performance A's breach must be material, but not as severe as the material breach that would allow B to rescind. Again the potential for confusion due to terminology is apparent.

⁵⁹ *Supra* n 56 at para [23]

⁶⁰ Lord Hodge considers Gloag & Irvine to present the balancing of accounts as a species of compensation. Gloag & Irvine do not support the view that balancing accounts operates to compensate debts although that may be the practical way the issue is dealt with by the creditor and insolvency practitioner – Gloag & Irvine, *Rights in Security*, *supra* n 10, 314-315.

⁶¹ Goudy, *Bankruptcy*, *supra* n 48, 550 – 551.

⁶² H Patrick, "Set off, related agreements and discretion: Supreme Court reverses *Inveresk v Tullis Russell*" 2010, *Corporate Rescue and Insolvency* 224 at 226

⁶³ Gloag & Henderson, *The Law of Scotland*, *supra* n 39, para 10.15

⁶⁴ McBryde, *Contract*, *supra* n 7, para 20-44 and the authorities cited there.

⁶⁵ McBryde, *ibid*, para 20-47; *Bank of East Asia Ltd v Scottish Enterprise* 1997 SLT 1213; *Macari v Celtic Football Club* 1999 SC 628

⁶⁶ Gloag, *Contract*, *supra* n 8, 594, *Inveresk* *supra* n 2 per Lord Hope at paras [42] and [43]

⁶⁷ *ibid*

⁶⁸ *Inveresk*, *supra* n 2, per Lord Hope at para [43].

⁶⁹ McBryde expresses doubt regarding the extent of materiality required, *Contract*, *supra* n 7, para 20-58 – 20.60; but see *Inveresk*, *ibid*, per Lord Hope at para [43] and *EDI Central Ltd v National Car Parks Ltd* 2011 SLT 75 per Lord Glennie at para [111].

The right to retain is often described as party B's security for counter performance from party A.⁷⁰ McBryde states the purpose of retention is to enforce obligations.⁷¹ It is argued that this is often the primary reason B will retain performance – to seek to force A to carry out the reciprocal obligation. However, it is suggested that mutuality retention goes further than that. It ensures B will not have to comply with his contractual obligation unless and until A performs or pays damages in lieu of performance.⁷² Suppose A and B agree that A will transport cargo for B. A transports the cargo but does so in such a way that damage is caused to it. A seeks payment of the freight from B. B refuses to pay – he retains payment – on the basis that A has breached the contract of carriage and as a result caused him loss. B might seek to recover the loss as a counterclaim in the action A raises for payment or raise a separate action against A to recover his loss. On the basis of mutuality retention B does not have to pay the freight until his claim against A has been determined. When that happens B's illiquid claim in damages becomes liquid and as such can be compensated against A's claim for freight.⁷³ B's right to retain exists so long as A's breach persists.⁷⁴ On damages being paid A's breach is made good such that B's retention is no longer justified.

It is in this respect that mutuality retention performs the same role as special retention – both delay performance until compensation may take place. It was in this regard that Lord Rodger considered special retention might have been of assistance to Tullis Russell in *Inveresk* if the court had not found in their favour on mutuality.⁷⁵ In this way the principles of mutuality retention and special retention have significant commonality in doctrinal and perhaps also in policy terms.⁷⁶ The difference is that in many cases mutuality retention will operate to compel performance by the other contracting party such that compensation will not subsequently take place.⁷⁷

While both special retention and mutuality retention are subject to the equitable control of the court mutuality retention is available unless the court considers its use inequitable⁷⁸ whereas special retention will only be available where the court considers it just and equitable to exercise its discretion to allow it.⁷⁹

(d) The Legal Framework

It is suggested that the legal framework can be depicted as:

⁷⁰ Bell *Princ* § 1410 and recently *McNeill v Aberdeen City Council*, 2014 SLT 312 per Lord Drummond Young at paras [27], [29], [30] and [34]

⁷¹ McBryde, *Contract*, *supra* n 7, para 20-64

⁷² Gloag, *Contract*, *supra* n 8, 625; *Fingland & Mitchell v Howie* 1926 SC 319 per Lord Anderson at 324.

⁷³ Gloag & Henderson, *The Law of Scotland*, *supra* n 39, para 10.16; HL MacQueen and J Thomson, *Contract Law in Scotland* (3rd ed, Bloomsbury Professional, Hayward Heath, 2012), para 5.21.

⁷⁴ McBryde, *Contract*, *supra* n 7, para 20-47

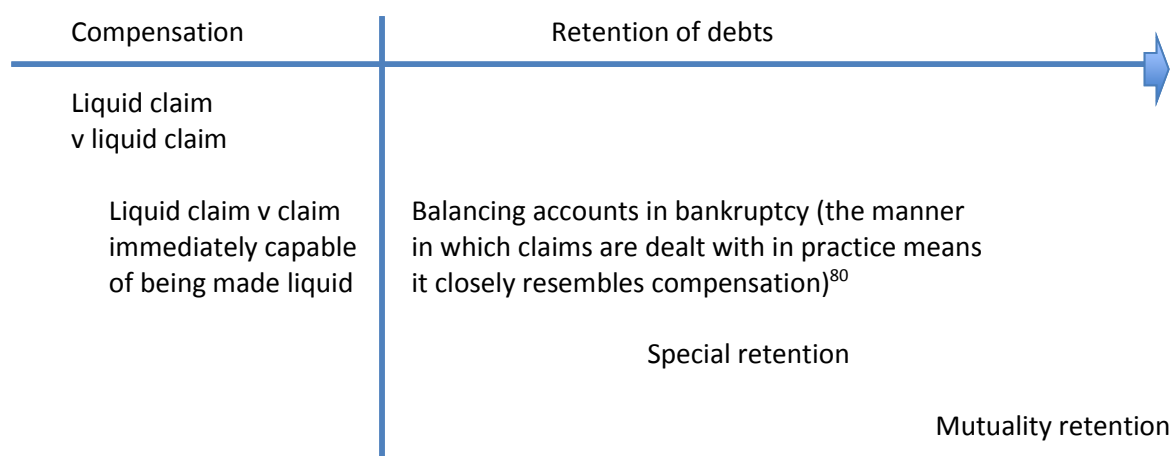
⁷⁵ *Inveresk* *supra* n 2 at paras [108] – [112]

⁷⁶ AM Godfrey, "Mutuality, retention and set off: *Inveresk plc v Tullis Russell Papersmakers Ltd*" 2011 *ELR* 115 at 120 argues that the doctrines have very little in common in doctrinal and policy terms.

⁷⁷ The party who withheld performance may still be able to claim damages from the contract breaker for losses suffered but would not have security for that claim by way of retention of performance.

⁷⁸ *McNeil*, *supra* n 70

⁷⁹ Gloag & Irvine, *Rights in Security*, *supra* n 10, 318; McBryde, *Contract*, *supra* n 7, para 25-58



B Examining Special Retention

Mutuality retention has been the subject of judicial and academic analysis. Far less is known about special retention. Indeed, until recently, special retention was in danger of being overlooked⁸¹ with retention of debts effectively equated with mutuality retention. However, there is clear authority that while the general rule is that where both parties are solvent a pursuer's liquid claim will not be delayed pending resolution of the defender's illiquid claim against him, where the claims do not arise from the same contract or transaction, the courts will allow another form of retention where equity or justice so demands. This form of retention – special retention - will only be allowed in exceptional or special circumstances by the exercise of the court's discretion.

While it is not possible to set out definitively when the court will and will not allow special retention it is submitted that the court will take certain factors into account. What these factors are and the impact they are likely to have on the exercise of the court's discretion are considered in this Part.

(1) Timing

In general the quicker the defender's claim will be made liquid the better chance of success he has with a plea of special retention. Lord Rodger refers to the fact that the defenders in *Inveresk* had raised a damages action, which had been sent to proof, as a factor that he would have taken into account had the court had to consider special retention.⁸²

In *Stewart & Co v Dennistoun*⁸³ special retention was refused despite a damages action having been raised against the pursuer. The Lord President and Lord Ivory noted that matters might have been different if the proof in the damages action had been due to take place the following week or at the court's next sitting, but the damages action was not so

⁸⁰ See note 60

⁸¹ Lord Rodger in *Inveresk*, *supra* n 2 at para [77]

⁸² *Inveresk* *ibid* at paras [109] and [112]

⁸³ (1854) 16 D 1061

advanced and involved inquiry into disputed facts in New Orleans and Hobson's Bay.⁸⁴ It would likely be quite some time before the damages claim was liquidated. In *M'Connell & Reid v W&G Muir*⁸⁵ the defenders were unable to retain payment of a liquid claim due under a contract of sale. There was a dispute between the parties as to whether the pursuers were in breach of an earlier sale contract. That dispute concerned title to goods. To resolve that dispute an action of multiplepoinding had been raised but was sisted pending the outcome of another action of multiplepoinding. Given the amount of time it would likely take for the defenders' claim to be determined the illiquid claim could not be said to be in the course of being made liquid.⁸⁶ The court refused special retention for similar reasons in *Niven v Clyde Fasteners Ltd.*⁸⁷

In *Munro v MacDonald's Executors*⁸⁸ special retention⁸⁹ was permitted. Munro sought payment of a legacy from the executors of 100 Pounds which had been bequeathed to him. The executors did not deny the legacy but pled it had been compensated by approximately 450 Pounds which had belonged to the deceased, which had been obtained and kept by Munro. The executors had raised an action against Munro for payment of 500 Pounds or for an account of the money entrusted to him by the deceased. The executors' action had been raised almost a week before Munro raised his action for payment of the legacy. The executors' case was set down for trial the following week. The court was unanimous. In those circumstances the court was willing to supersede further disposal of Munro's action against the executors until the outcome of the executors' action against Munro was known. In Lord Curriehill's view where an illiquid claim was in the fair course of being made liquid by decree at an early date and where there was no allegation of delay on the part of the defenders in prosecuting their claim, the court was entitled to exercise its discretion.⁹⁰ Lord Deas commented that if the case had been in the same position as it had been when it was before the Lord Ordinary⁹¹ he may have refused to postpone giving judgment against the executors but as the circumstances were now different, with the executors' case against Munro being heard the following week, he was content to supersede disposing of Munro's action.

Lord Deas's comments can be contrasted with the decision in *Scottish North Eastern Railway Co v Napier*⁹² in which special retention was refused despite the fact that, by the time the appeal was heard, a proof in the defender's action against the pursuer had taken place with a finding that the pursuer has caused loss to the defender. The Second Division was aware the parties had incurred significant expense in dealing with the action prior to the appeal and that the effect of their decision was effectively to throw that money away. As such, if they had felt able to adhere to the sheriff's decision they would have done so but felt compelled to hold otherwise. The reason for the court's decision was a simple application of the rule that an illiquid claim cannot delay payment of a liquid claim. The pursuer's claim for transporting the defender's goods was liquid. The defender's claim for

⁸⁴ *Ibid* at 1064

⁸⁵ (1906) SLT 79

⁸⁶ *Ibid* per Lord Stormonth Darling at 82

⁸⁷ 1986 SLT 344

⁸⁸ (1866) 4 M 687

⁸⁹ The case did not deal with the extinguishing of debts but of delaying judgement in one case pending the outcome of another. Lord Rodger refers to this case as a case of retention pending compensation in *Inveresk*, *supra* n 2 – see paras [97] – [98]

⁹⁰ *Supra* n 88 at 688

⁹¹ The executors' action appears to have been some way from conclusion when Munro's action was heard at first instance – *ibid* at 690 note 1.

⁹² (1859) 21 D 700.

loss resulting from another contract between the parties was illiquid. Lord Wood noted that the pursuer should have obtained immediate decree for the admitted claim four years earlier.⁹³ At the time special retention had been permitted by the sheriff there were no special circumstances justifying the exercise of discretion to delay payment of the liquid claim pending liquidation of the defender's claim against the pursuer. That the circumstances had changed with the intervening proof since the sheriff's decision did not alter that outcome for the Second Division.

If the defender has had a right of action against the pursuer for some time and has not raised proceedings to liquidate that claim the illiquid claim will not be close to becoming liquid. The fact the defender has delayed taking action against the pursuer will be a further factor against special retention being allowed. In *Tait v Mackintosh*⁹⁴ the court held that the fact the defender had retained the pursuer in his service for four years was a bar to the defender being able to plead, as a counterclaim for the pursuer's demand for wages, damages alleged to have arisen from the pursuer's inebriety, neglect or fault in the discharge of his duties. This was especially so given that no complaint had been made regarding the pursuer's conduct during the period of his service. It was only when the action for payment of wages was raised that the defender raised the issue of damages. In *Mackie v Mackie*⁹⁵ the fact that the defender had had a claim against the pursuer for a considerable period of time which he had not sought to pursue until the pursuer's action against him pointed against allowing special retention. The Lord Ordinary noted it "looks as if it has been raised to get out of his liability in the action [against him]".⁹⁶

The court will not look favourably on a defender who pleads special retention late in the day, once the claim against him is well underway. Any delay by the defender in raising the issue, as well as seeking to prosecute his claim against the pursuer, will militate against the court exercising its discretion in the defender's favour. In *Pegler v Northern Agricultural Implement and Foundry Company (Limited)*⁹⁷ the pursuer sought payment of sums due under his contract of employment. The defenders did not dispute that the sums were due but defended the action on the basis that the pursuer had not complied with certain obligations incumbent upon him as an employee.⁹⁸ The action had been raised by the pursuer in mid March and decree was granted against the defenders by mid June. The defenders reclaimed. The reclaiming note⁹⁹ was heard by the court in January of the following year. At that stage no averments had been made setting out the defenders' claim against Pegler. Those averments did not appear until the defenders later amended their pleadings. It is not clear from the report when that happened but it was at least ten months after the action against them had commenced. The defenders' action against Pegler had only been served about three weeks prior to the court's opinion being delivered in the action raised by Pegler. The Lord President considered the defenders' claim of retention as "laboring under the disadvantage that it was plainly an afterthought."¹⁰⁰ Lord Deas

⁹³ *Ibid* at 705

⁹⁴ 26 Feb 1841, Decisions of the Court of Session collected by Robertson and Taylor, 12 Nov 1840 – 20 Jul 1841

⁹⁵ (1897) 5 SLT 42

⁹⁶ *Ibid* at 44

⁹⁷ (1877) 4 R 435

⁹⁸ This seems to be a case of mutuality retention but was not dealt with as such by the majority. See Lord Shand's dissent.

⁹⁹ A reclaiming note is used to appeal a decision.

¹⁰⁰ *Supra* n 97 at 439

commented, “a man is not to be kept out of his money by a defence got up *ex post facto*, which raises the strongest presumption that it is not well founded.”¹⁰¹

(2) Whether the Defender has a Prima Facie Case Against the Pursuer

The court will also look at the extent to which the defender can state his claim against the pursuer. The court will consider whether the defender has set out, in sufficient detail, in his pleadings his claim against the pursuer. This is likely to be tied to the speed of liquidating his claim given that a case is unlikely to proceed to proof until the parties’ pleadings are in order. However, case law indicates that the extent to which the defender has set out his claim is a separate factor, which is weighed in the exercise of judicial discretion, in coming to a decision on whether or not special retention will be allowed.

This issue arose in *Lawson v Drysdale*¹⁰² where the Second Division refused to supersede extract,¹⁰³ where damages had been found due by Drysdale to Lawson for breach of a partnership agreement, pending the outcome of Drysdale’s action of count and reckoning against Lawson. Lord Cockburn was clear that the decree for damages could not be stopped by “a vague general statement of claims that may be substantiated in another process.”¹⁰⁴

The court looks at whether the defender has a *prima facie* case against the pursuer.¹⁰⁵ In *Stewart v Dennistoun* Lord Ivory remarked, “There is not even a *prima facie* case here. I cannot take a mere allegation,... as a ground for interfering with this liquid obligation...”¹⁰⁶ In *Logan v Stephen*¹⁰⁷ the pursuer, Stephen,¹⁰⁸ was granted decree against Logan for wages due to him. Logan defended the action on the basis that Stephen, who was a farm griever¹⁰⁹ or labourer on Logan’s farm, was cautioner in an obligation owed by Logan’s clerk who had absconded owing money to Logan. Logan claimed to be entitled to relief from Stephen for losses he had sustained as a result of the clerk’s breach of obligation, for which Stephen was cautioner. There were difficulties with the form of the cautionary obligation, which required proof of *rei interventus* to support it, but no action to constitute the cautionary obligation had been taken by Logan. Ultimately Lord Fullarton was of the view that,

whatever might ultimately be found to be the merits of the defender’s claims on the cautionary obligation when properly investigated, they could not, in their present vague form, afford a good ground of retention...¹¹⁰

¹⁰¹ *Ibid* at 440

¹⁰² (1844) 7 D 153

¹⁰³ See note 31

¹⁰⁴ *Supra* n 102 at 155

¹⁰⁵ *Lawson v Drysdale*, *supra* n 102 per the Lord Justice Clerk at 154; *M’Connell & Reid v W&G Muir*, (1906) SLT 79 per Lord Kyllachy at 82

¹⁰⁶ (1854) 16 D 1061 per Lord Ivory at 1064

¹⁰⁷ (1850) 13 D 262

¹⁰⁸ The parties’ names changed position on appeal.

¹⁰⁹ A manager, overseer or bailiff on a farm – *New Shorter Oxford English Dictionary*, (5th ed, Clarendon Press, Oxford, 1993), Vol 1

¹¹⁰ *Supra* n 107 at 266

Lord Cunninghame was particularly scathing of Logan's claim against Stephen. He considered Logan's illiquid claim to be "of a very unfavourable, if not an incredible aspect".¹¹¹ The court held that Logan should not be able to retain the wages due to Stephen pending determination of his claim against Stephen as cautioner. The lack of a case against the pursuer in the defender's counterclaim on the face of the pleadings was a factor in the court's decision in *Mackie v Mackie*.¹¹²

(3) A Blameworthy Pursuer

The factors discussed so far have focused on what the defender has or has not done. With this factor the court considers the pursuer's conduct, in particular, what it is that the pursuer is alleged to have done that forms the basis of the defender's claim against him. McBryde refers to this as the "liquid claimant [who] does not come into court with 'clean hands.'"¹¹³ That this is taken into account reflects the equitable nature of special retention.

Perhaps the most striking example is found in *Ross v Ross*¹¹⁴ which concerned an action by Lady Ross against her son for payment of an annuity. The son did not deny that Lady Ross had a right to the annuity but denied that any part of the annuity was owed by him to her on the basis of a number of claims he had against her, one of which related to intromissions made in his estate during his minority. In respect of this claim he had raised an action of count reckoning and payment against Lady Ross in which he sought payment of £70,000.

Lord Adam noted that he was very unwilling to cast any doubt on the well-established rule that illiquid claims cannot be set off against liquid claims. However, the rule was not without some exceptions and there may be cases in which it was not desirable or necessary that immediate decree should be given. He considered this a "very exceptional case" due to the fact that, following Lady Ross's intromissions with the estate over the ten year period during which she was her son's tutor and with the rental value of the estate being £16,000 per year, the estate was left with a debit balance. The manner in which Lady Ross had carried out her duties was heavily criticised.¹¹⁵ In the circumstances of the case Lord Adam did not think it would be consonant with justice to give Lady Ross immediate decree. Lord M'Laren considered the equitable nature of the right of retention, commenting,

..the Lord Ordinary has rightly dealt with the plea of compensation, because that is a matter of statutory regulation, and the plea is confined to cases where both debts are liquid or capable of immediate ascertainment; but then there is another principle under which one obligation may be suspended until the performance of a counter obligation – the principle of retention, and that, not being subject to the conditions of any statute, must be regarded as an equitable right to be applied by the Court according to the circumstances of each case as it shall arise.¹¹⁶

¹¹¹ *Ibid* at 267

¹¹² (1897) 5 SLT 42 at 44

¹¹³ McBryde, *Contract, supra* n 7, para 25-58

¹¹⁴ (1895) 22 R 461

¹¹⁵ *Ibid* at 464

¹¹⁶ *Ibid* at 464-465. The counter obligation referred to is not a contractual counterpart obligation which would allow mutuality retention to be pled. The case did not involve obligations by both parties arising from the same contract or transaction – Lady Ross's obligations arose from her position as her

Lord M'Laren noted that in managing the estate on her son's behalf Lady Ross seems to have wholly neglected her duty to keep clear accounts. It was unanimously held that the defender was able to delay paying the annuity. The court superseded disposal of the case until there was a change in circumstances that would allow the court to dispose of it more satisfactorily, presumably once a decision was available in the son's action of count, reckoning and payment.

It will not, of course, be every breach of duty by the pursuer which will allow the defender to retain payment of a liquid debt. In an earlier case¹¹⁷ on similar facts to *Ross v Ross* the plea by a son, based on his mother's intromissions while tutrix, was repelled and the mother was able to enforce her decree for bygone annuities. It appears from the short case report that the mother's intromissions while tutrix would be considered in a separate ongoing action but no details of that action, in particular, what she was alleged to have done in her dealings with the estate, are given. The court in *Ross v Ross* was heavily influenced by the extent of the apparent breaches of duty by Lady Ross.

(4) Where the Principal Debtor is Deceased

Some cases suggest that if the defender is sued on the basis of a debt which has been inherited this will be a factor taken into consideration by the court in exercising its discretion. This seems to have influenced the court in the cases of *Seton*¹¹⁸ and *Muir and Milliken v Kennedy*,¹¹⁹ discussed above. In the former case the defender was the widow of the pursuer's debtor and was allowed a period of time to make her deceased's husband's claim liquid. In the latter case the defender's position as heir of a cautioner seems to have been a particularly important factor in him being granted a term to prove his illiquid claim.¹²⁰

(5) The Basis of the Pursuer's Claim

As noted above the basis for the general rule that illiquid claims cannot delay payment of liquid claims is based on the principle that a creditor should not be denied a sum clearly due to him pending the outcome of an illiquid claim against him, although equity or justice may require exceptions to be made. The cases suggest that certain liquid claims may be more important and less liable to equitable exception than others.

A factor that the court has shown itself to be influenced by is the nature of the pursuer's claim. Often a pursuer will raise an action for payment of his liquid claim.¹²¹ The basis for that claim may be an important consideration. This is seen in *Logan v Stephen*, discussed above. As well as the problems with the defenders' case against Stephen the fact that Stephen was suing for his wages influenced the court's decision. Lord Fullerton was of the opinion that the defender's claims against Stephen did not provide a good ground of retention against "a demand so liquid, so urgent, and even alimentary in nature, as that for

son's tutor; the annuity arose under a marriage contract. See the discussion of this issue by Lord Rodger in *Inveresk supra* n 2 at para [103].

¹¹⁷ *Gordon of Badinscoth v Gordon of Inverebry* (1715) Mor 2562

¹¹⁸ (1683) Mor 2566

¹¹⁹ (1697) Mor 2567

¹²⁰ As noted above the fact the defender offered to prove the sum sued for had been paid was also a factor.

¹²¹ The pursuer may have raised another action, eg damages, with his claim becoming liquid when the court grants decree in his favour.

wages.”¹²² Lord Cunninghame also referred to the plainly alimentary nature of the labourer’s wages.¹²³ This was also a factor influencing the court in *Pegler*, discussed above, with Lord Deas noting,

[t]he wages or salary of a servant is a strong instance of the reasonableness of this rule [that illiquid claims should delay payment of liquid claims], for otherwise the servant would be indefinitely kept out of what is intended for his means of livelihood.¹²⁴

The effect of withholding payment of the pursuer’s claim was also referred to by the Lord President in *Munro v MacDonald’s Executors* who seemed to be encouraged in his decision that the defenders could retain the legacy sued for on the basis the pursuer was not “put to straits” having received a sum of money shortly before the deceased’s death, which sum was the subject of the defenders’ action against the pursuer.¹²⁵

Where the pursuer’s claim is based on unjustified enrichment the court will be more likely to allow retention by the defender on the basis that the remedy sought by the pursuer is equitable. Consequently the equity of the situation between the parties must be balanced. This can be contrasted with the position when special retention is sought where the defender has to demonstrate that equitable considerations are such that the court should allow an exception to the well-established rule that illiquid claims cannot be used to meet liquid claims. A claim based on unjustified enrichment gives the court a wider discretion to allow retention. This is seen in the opinions in *Henderson & Co Limited v Turnbull & Co*¹²⁶ and *G&A Kirkpatrick v Kirkpatrick’s Executrix*.¹²⁷ In the former case Lord Ardwall¹²⁸ noted that the *condictio indebiti*, as an equitable remedy, would not be granted unless it clearly appeared to the court inequitable for the defender to keep the payment that the pursuer sought to recover.¹²⁹ While such cases are often argued on the basis that the defender cannot seek to retain an illiquid claim in the face of the pursuer’s liquid claim, cases where the pursuer’s claim is based on unjustified enrichment deal with the operation of unjustified enrichment remedies rather than when special retention will be allowed and as such will not be considered further.

(6) Where the Defender’s Claim is Close to but Falls Short of Mutuality Retention

In *Inveresk*¹³⁰ the court held that Tullis’s obligation to pay under the asset purchase agreement was the counterpart of certain obligations due by Inveresk under the services agreement which Tullis claimed Inveresk had breached. As such mutuality retention was available. However, Lord Rodger noted, *obiter*, that had the court had to consider special retention he would have taken into account the fact that Tullis’s damages claim related to breaches that were inextricably linked with the contract in terms of which Inveresk sought payment as a factor that might have been enough to allow special retention.¹³¹ In *Countess*

¹²² (1850) 13 D 262 at 266

¹²³ *Ibid* at 267

¹²⁴ *Pegler v Northern Agricultural Implement and Foundry Co* (1877) 4 R 435 at 439

¹²⁵ (1866) 4 M 687 at 688

¹²⁶ 1909 SC 510

¹²⁷ 1983 SLT (Sh Ct) 3

¹²⁸ With whom the Lord Justice Clerk and Lord Dundas concurred

¹²⁹ *Supra* n 126 at 521

¹³⁰ *Inveresk supra* n 2

¹³¹ *Ibid* at paras [110] – [112]

of *Cawdor v Cawdor Castle (Tourism) Ltd*¹³² the fact that the principal claim by a former company director for repayment of a loan and a counterclaim relating to sums expended by the pursuer while she was a director were closely related influenced Lord Bracadale in allowing the defence of retention to proceed to a proof before answer.

C Analysis of Factors

(1) Analysis

Having identified the factors influencing the court's decision on whether to allow special retention these factors will now be analysed.

If special retention is sought it is important that this is pled as early as possible (factor 1). This is particularly important where there is no substantive defence to the pursuer's liquid claim¹³³ because without the plea of special retention the pursuer will be entitled to seek summary decree.¹³⁴ Special retention will likely come too late where the defender's claim has existed for some time and he has done nothing to progress that claim against the pursuer. It is argued that it is fair that the court looks unfavourably on defenders who raise special retention as an afterthought rather than based on a genuine claim the defender has, and is in the process of taking forward, against the pursuer.

The writer is aware of some anecdotal evidence of special retention being raised in a number of cases where banks have sought repayment of loans from borrowers. In these cases there is no dispute that the sums have been provided to the borrower and are due to be repaid. The borrower seeks to delay repayment on the basis that he has a claim against the bank for breach of duty which is unrelated to the loan and which often occurred some time ago but in respect of which no action has been taken by the borrower against the bank. In such a case the defender has failed to progress his claim, which is a contraindication to special retention being allowed. The court should allow decree to pass against the borrower in the absence of other factors indicating that special retention should be permitted. The borrower is not prevented from pursuing his claim against the bank following decree in the bank's favour.¹³⁵

As much information as possible should be included in the pleadings about the defender's case against the pursuer (factor 2). Without sufficient information the defender will have difficulty demonstrating his *prima facie* case against the pursuer. In the bank/borrower cases discussed above the exact breach of duty by the bank and averments to support it are often lacking with vague claims made by the borrower. In some cases it might be said that the borrower is making a "hopeless attempt to get out of a desperate position."¹³⁶ This further indicates that in such cases special retention should not be permitted.

It is suggested that it is equitable to restrict special retention to a defender who is able to articulate his claim against the pursuer clearly. If the defender has a genuine claim it should be possible without too much difficulty to plead it. A defender who is unlikely to be

¹³² [2007] CSOH 134

¹³³ In many cases in which special retention was sought the defender does not dispute the liquid sum is due to the pursuer; the sole basis for not paying is his illiquid claim against the pursuer.

¹³⁴ Rules of the Court of Session 21.2; Ordinary Cause Rule 17.2

¹³⁵ Although it may affect the defender's ability to finance that action

¹³⁶ *Scottish North Eastern Railway Company v Napier* (1859) 21 D 700 per Lord Cowan at 705

successful in his claim against the pursuer should not be able to delay the pursuer's liquid claim pending his attempt to liquidate his claim.

If an action is raised by a party whom the defender claims has committed a gross breach of duty against him this may persuade the court to allow special retention (factor 3). It is argued that in exercising an equitable discretion the court should take account of what it is the pursuer is said to have done that founds the basis of the plea of special retention. It should not be any breach by the pursuer that allows special retention, only grave or gross breaches, otherwise special retention could be pled in any case where the defender has a claim against the pursuer for breach of contract or some other duty owed to the defender.

The cases in which the principal debtor was deceased (factor 4) might be explained on the basis that because the defenders were not the principal debtors and were essentially dealing with the affairs of another it was just and equitable that they be given a period of time to make the deceased's illiquid claim liquid. A party in the defenders' position, faced with court proceedings, will often not have all of the details of the deceased's claim against the pursuer available and, of course, the party likely to have the information needed to formulate the claim against the pursuer – the deceased – is unable to provide it. A short period for a defender to investigate matters, particularly where the defender has only recently started to deal with the deceased's affairs and may not have been able to fully consider matters relating to the estate, appears to be just. As such if a claim is made against an executor for sums due to the pursuer by the deceased, an executor, who is aware of an illiquid claim which the deceased had against the pursuer, might be allowed a period of time to investigate and make that claim liquid before being required to pay the sum due to the pursuer from the estate. However, it is submitted that if the executor or, indeed, the principal debtor while alive, delayed in seeking to liquidate the claim against the pursuer this will militate against special retention given the importance of timing and acting without delay.

If the sum sued for by the pursuer is alimentary in nature or needed for the pursuer's subsistence it is highly unlikely that the court will allow special retention (factor 5). This is a feature of many European legal systems.¹³⁷ It appears fair that payments that are really needed by the pursuer are a contraindication to permitting special retention although perhaps the urgency of the pursuer's need in the 21st century, with a welfare and benefits system, is less pressing than in the past.

While the Supreme Court's decision in *Inveresk* makes clear that the unity of a transaction should be respected, with all obligations in a contract being considered the counterparts of each other unless there is a clear indication to the contrary,¹³⁸ there are likely to be cases where there is some concern regarding the applicability of mutuality retention. In such a case the defender may wish to plead both mutuality retention and special retention based on the inter-connectedness of the parties' obligations (factor 6). In this way the defender gives himself a second basis on which to retain should the court come to the view that the obligation he is withholding is not the counterpart of the obligation breached by the pursuer. Special retention requires a plea-in-law separate to and different from the plea of mutuality retention. This stems from the fact that for special retention the defender must ask the court to exercise its discretion to allow him to retain payment. He has

¹³⁷ R Zimmermann, *Comparative Foundations of a European Law of Set Off and Prescription*, (Cambridge University Press, Cambridge, 2002), 57

¹³⁸ *Inveresk supra* n 2 at paras [42] and [43]

no right to retain unless and until the court so decides. As such the plea-in-law used for mutuality retention is inappropriate.¹³⁹

(2) Limited Availability of Special Retention

The cases stress the importance of the general rule that a party with a liquid claim should receive satisfaction of his claim without having to await the resolution of his debtor's illiquid claim.¹⁴⁰ The small number of cases in which special retention has been permitted testifies to the strength of that rule. For Lord Rodger the general rule reflected sound legal policy, and as such will usually be the equitable course to pursue.¹⁴¹ It is, however, clear that the rule is not without exception where justice and equity so require.

The defender in cases in which a plea of special retention has been sustained has had to demonstrate to the court why his case is sufficiently special or exceptional to merit a departure from this important rule. While a court's decision on whether or not to exercise its discretion to allow special retention is "always a question of circumstances, and of sound judicial discretion and equity"¹⁴² it is argued that there are certain factors that have clearly influenced the court in exercising its discretion. These factors provide a framework against which a court can decide whether special retention should be allowed on the facts of a particular case. While a decision on whether or not to allow special retention is an exercise of judicial discretion there are authorities that can shape the exercise of that discretion and will be of assistance to judges asked to consider a plea of special retention. Judges should look to these factors to help them make their decisions. Doing so ensures certainty and predictability in this area of the law.¹⁴³

Conclusion

In seeking to determine the boundary between compensation and retention of debts in Scots law it is contended that compensation is a narrower principle than previously understood, encompassing only claims that are capable of extinguishing each other – liquid claims and those *immediately* capable of being made liquid. The concept of a wider doctrine of compensation, where periods of time were allowed for illiquid claims to be made liquid,¹⁴⁴ is a result of lack of analysis and the use of inconsistent terminology. When analysed, a wider concept of compensation based on the maxim *quod statim liquidari potest pro jam liquido habetur*, is truly special retention.

¹³⁹ Lord Rodger in *Inveresk*, *ibid*, para [106]

¹⁴⁰ See the authorities cited at n 16

¹⁴¹ *Inveresk*, *supra* n 2 at para [107]

¹⁴² *Logan v Stephen* (1850) 13 D 262 per Lord Cunningham at 267

¹⁴³ Professor Whitty argues convincingly that judicial discretion is not entirely free but is constrained by rules, principles, values or other standards. He argues that where a judge has a very wide discretion he may feel obliged to use informal rules of thumb that have been developed in other cases as *prima facie* applicable to the case in hand to achieve sufficient certainty and predictability - N Whitty, "From rules to discretion: changes in the fabric of Scots private law", 2003 ELR 283, in particular at 299-300. Goff J had difficulty applying the wide statutory discretion in s1(3) of the Law Reform (Frustrated Contracts) Act 1943 in *BP Exploration Co (Libya) Ltd v Hunt (No 2)* [1979] 1 WLR 783.

¹⁴⁴ See the discussion at pages 3-4

The doctrine of retention of debts is a wider doctrine that previously understood, encompassing the balancing of accounts in bankruptcy, special retention and mutuality retention. In all of these categories payment can be withheld or retained until the defender's claim is liquidated. When that occurs compensation may take place.¹⁴⁵ It is here that mutuality retention and special retention operate to the same end.

The court must consider each case on its own facts and circumstances in determining whether to exercise its discretion to allow special retention. Definitive rules that will apply to all cases have not been set down. However, guidance is available to determine whether the court will or will not exercise its discretion. The case law reveals certain factors that have influenced the court's decision making. There is a backdrop of authorities against which to assess whether special retention should be permitted which can and should be referred to by a judge faced with a claim of special retention. It might be that over time certain categories where special retention will or will not be permitted will be established as has arguably occurred in relation to the court's discretion to refuse specific implement.¹⁴⁶ Of course, with specific implement the court has a discretion to refuse to grant the order sought whereas the court must exercise its discretion in order to allow special retention. In both cases the discretion will only be used in exceptional cases.¹⁴⁷

Special retention has not featured heavily in Scottish cases over the centuries. It is hoped that analysis of this category of retention will allow it to be used in appropriate cases. Contrary to Lord Rodger's fear that special retention's existence would continue to be overlooked¹⁴⁸ that does not seem to be the case following *Inveresk*¹⁴⁹ where anecdotal evidence suggests it is being raised relatively frequently but in many cases, it seems, inappropriately with the result that some see it as a defender's charter. The case law has consistently emphasised the importance of the general rule that illiquid claims cannot delay liquid claims.¹⁵⁰ Lord Rodger himself made this clear when he noted that the general rule simply reflects what is considered to be sound legal policy, is usually the equitable course to pursue and that he would not weaken the general rule in any way.¹⁵¹ It will only be in exceptional or special circumstances that an illiquid claim will be allowed to delay enforcing a liquid claim. The small number of cases where special retention has been permitted since the sixteenth century is testament to that.

¹⁴⁵ As noted above another and important function of mutuality retention is to seek to force the other party to perform their contractual obligations. When the contracting partner performs the right to retain disappears and compensation will not take place.

¹⁴⁶ McBryde *Contract*, *supra* n 7, para 23-15; L Macgregor, "Specific performance in Scots law" in J. Smits, D. Haas, and G. Heslen, *Specific Performance in Contract Law: National and Other Perspectives*, (Intersentia, Antwerp, Oxford, 2008), 72 and 76; and L Macgregor and H Macqueen, "Specific implement, interdict and contractual performance", 1999 ELR 239 at 240.

¹⁴⁷ On specific implement see McBryde, *Contract*, *supra* n 7, para 23-15; on special retention see the comments on pages 9 and 18 above

¹⁴⁸ *Inveresk*, *supra* n 2 at para [77]

¹⁴⁹ *Supra* n 2

¹⁵⁰ See the cases cited at n 16

¹⁵¹ *Supra* n 2 at para [107]